

The Basics of HSAs

U.S. Treasury Department
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HSA Overview

- HSA is money put in an account owned by an individual to pay for future medical expenses
- Must be used in conjunction with “High Deductible Health Plan” (HDHP)
 - Insurance that does not cover first dollar medical expenses (except for prevention)

HSA Overview

- HSAs were created in Medicare legislation signed into law by President Bush on December 8, 2003
- HSAs modeled after Archer MSAs
 - Created in 1996
 - Limited in many ways
 - Who could have
 - Total number created

Who Is Eligible for HSAs?

- Any individual that:
 - Is covered by a HDHP
 - Is not covered by other health insurance
 - does not apply to specific injury insurance and accident, disability, dental care, vision care, long-term care
 - Is not eligible for Medicare
 - Can't be claimed as a dependent on someone else's tax return
- Contrast with Archer MSA rules
 - Had to be employed by small employer (50 or fewer)

What Is a “High Deductible Health Plan” (HDHP)?

- Health insurance plan with minimum deductible of:
 - \$1,000 (self-only coverage)
 - \$2,000 (family coverage)
- Annual out-of-pocket (including deductibles and co-pays) does not exceed:
 - \$5,000 (self-only coverage)
 - \$10,000 (family coverage)
 - These are lower than Archer MSAs
- HDHPs can have:
 - first dollar coverage (no deductible) for preventive care
 - higher out-of-pocket (copays & coinsurance) for non-network services

HSA Contribution Rules

- Contribution to HSA can be made by either the employer or the individual, or both
 - If made by the individual, it is an “above-the-line” deduction
 - If made by the employer, it is not taxable to the employee (excluded from income)
 - Can be made by others on behalf of individual and deducted by the individual
- All contributions are aggregated

HSA Contribution Rules

- Maximum amount that can be contributed to an HSA (and deducted) = lesser of:
 - Amount of High Deductible
or
 - Maximum specified in law (indexed annually by M-CPI)
 - \$2,600 (self-only coverage) - 2004
 - \$5,150 (family coverage) - 2004
- Reduced by any contribution to an Archer MSA

HSA Contribution Rules

	Deductible	Out-of-Pocket Maximum	Maximum HSA Deposit (2004)
Single Coverage	\$1,000	\$5,000	\$1,000
	\$1,500	\$5,000	\$1,500
	\$2,000	\$5,000	\$2,000
	\$2,500	\$5,000	\$2,500
	\$3,000	\$5,000	\$2,600
Family Coverage	\$2,000	\$10,000	\$2,000
	\$3,000	\$10,000	\$3,000
	\$4,000	\$10,000	\$4,000
	\$5,000	\$10,000	\$5,000
	\$6,000	\$10,000	\$5,150

HSA Contribution Rules

- HSA contribution rules more generous than Archer MSAs
 - Contributions to Archer MSAs are limited to:
 - 75% of the deductible amount for family (65% for self-only plans)
 - Employee's compensation or self-employment income
 - If employer made a contribution, employee could not

HSA Contribution Rules

- For individuals age 55 and older, additional “catch-up” contributions to HSA allowed
 - 2004 - \$500
 - 2005 - \$600
 - 2006 - \$700
 - 2007 - \$800
 - 2008 - \$900
 - 2009 and after - \$1,000
- Contributions must stop once an individual is eligible for Medicare

HSA Contribution Rules

- Rollovers from Archer MSAs and other HSAs permitted
- Contributions can be made through cafeteria plans
- Employer contributions to HSA must be “comparable” for all employees participating in the HSA
 - If not comparable, there will be an excise tax equal to 35% of the amount the employer contributed to employees’ HSAs

HSA Contribution Rules

- In order to meet the requirement that the employer make comparable contributions, the employer must make contributions:
 - which are the same amount
 - or
 - which are the same percentage of the annual deductible
- Count only employees who are eligible individuals covered by the employer and who have the “same category of coverage” (i.e., self-only or family)
- Part-time employees are tested separately
 - “Part-time” means customarily employed fewer than 30 hours per week

HSA Distributions

- Distribution is tax-free if taken for “qualified medical expenses”
 - Now includes over-the-counter drugs
- Cannot be used to pay for other health insurance except:
 - COBRA continuation coverage
 - Health plan coverage while receiving unemployment compensation
 - For individuals eligible for Medicare:
 - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, new prescription drug coverage)
 - employee share of premiums for employer-based coverage
 - Cannot pay Medigap premiums
 - Qualified long-term care insurance

HSA Distributions

- Distributions are tax-free if taken for:
 - person covered by the high deductible
 - spouse of the individual
 - any dependent of the individual
- Spouse and dependents don't need to be covered by the HDHP
- If not used for qualified medical expenses, then amount is included in income
- 10% additional tax if taken for non-medical expenses, except when taken after:
 - Individual dies or becomes disabled
 - Individual is eligible for Medicare
- Compare to 15% additional tax for Archer MSAs

HSA Distributions

- HSA custodian must report all distributions
 - not required to check for eligibility
- Under Archer MSA rules, the MSA custodian does not have to determine whether MSA distributions are used for medical purposes; the individual does that
- Given the less stringent distribution rules for HSAs, we assume many Archer MSA holders will rollover to HSAs

HSA Distributions

- Should the HSA account holder keep receipts?
 - YES! May need to prove that deductible was met
 - Not all medical expenses paid out of the HSA have to be charged against the deductible (e.g. dental care, vision care)

Estate Treatment of HSAs

- If married, the spouse is treated as the owner
- In other cases:
 - The account will no longer be treated as an HSA upon the death of the individual
 - The account will become taxable to the recipient of it (including the estate of the individual)
 - Taxable amount will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HSA
 - The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into the deceased individual's estate

Advantages of HSAs

- HSA accounts encourage savings for future medical expenses
 - Non-covered services under future coverage
 - When employer-sponsored coverage is lost during periods of unemployment
 - COBRA continuation coverage
 - other coverage
 - Medical expenses after retirement (before Medicare eligibility)
 - Insurance coverage after Medicare eligibility (except Medigap)
 - Out-of-pocket expenses for Medicare
 - Long-term care expenses

Advantages of HSAs

- Accounts are owned by the individual (not an employer). The individual decides:
 - How much to contribute
 - How much to use for medical expenses
 - Which medical expenses to pay from the account
 - Whether to pay for medical expenses from the account or save the account for future use
 - Which company will hold the account
 - What type of investments to grow account

Advantages of HSAs

- Accounts are completely portable, regardless of:
 - Whether the individual is employed or not
 - Which employer the individual works for
 - Which state an individuals moves to
 - Age or marital status changes
 - Future medical coverage

Advantages of HSAs

- No “use it or lose it rules” like Flexible Spending Arrangements (FSAs)
 - Unspent balances in accounts remain in the account until spent on medical care
 - Encourages account holders to spend their funds more wisely on their medical care
 - Encourages account holders to shop around for the best value for the health care dollars
- Accounts can grow through investment earnings, just like an IRA
 - Many different investment options could be pursued
 - Individual chooses investment option that best meets their needs

Advantages of HSAs

- HDHP premiums should be cheaper than health insurance with traditional deductibles
- Favorable tax treatment
 - Contributions
 - Disbursements
 - Investment earnings
- President Bush has proposed an above-the-line deduction for HDHP premiums

How to Open an HSA

- Purchase HDHP coverage
 - Check current insurance company
 - Contact licensed agent or broker
 - Contact state insurance department
- Establish a “trustee”
 - Banks
 - Credit unions
 - Insurance companies
 - Model form available

Treasury Assistance

- Web site
 - www.treas.gov
- Voice mailbox
 - (202) 622-4HSA
- E-mail address
 - HSAInfo@do.treas.gov
- Taking referrals from 1-800-MEDICARE